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Globalization and interdependence: development cooperation with middle-income countries

Development cooperation with middle-income countries

Report of the Secretary-General

Summary

In aggregate, middle-income countries have shown robust growth and made progress in development, although performance varies among them. If history is a reference, countries in this group are vulnerable to being caught in a so-called "middle-income trap", where they lose competitiveness compared to low-income countries but lack the technological edge to catch up with high-income countries. The challenge is to redesign development strategies for them with a focus on innovative, sustainable and inclusive growth, gradually shifting to higher value added sectors.

The United Nations system is playing an important role in assisting middle-income countries in their economic and social development, as is indicated by both the replies of Governments to a survey and the reports on specific programmes and initiatives implemented by United Nations agencies. While the various forms of assistance provided by the United Nations system are a reflection of the effort to tailor initiatives to the needs of individual countries, significant further gains could possibly be achieved by developing a comprehensive strategic framework for development cooperation with middle-income countries.

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I. Introduction

1. At its sixty-sixth session in 2011, the General Assembly highlighted the fact that middle-income developing countries still face significant economic and social challenges, especially regarding poverty eradication, and that efforts to address those challenges should be supported in order to ensure that the achievements so far are sustained, including through support of the effective development of comprehensive cooperation policies.

2. In resolution 66/212, the General Assembly requested the Secretary-General to submit a report on development cooperation with middle-income countries to it at its sixty-eighth session. The present report responds to this request. Reference is also made to resolution 64/208, which included a focus on the existing strategies and actions of the United Nations system on development cooperation with middle-income countries, taking into account the work of other relevant international organizations, including international financial institutions.

3. Similarly to the previous report on this matter (A/66/220), the present report tentatively identifies middle-income countries as those with a per capita gross national income (GNI) of between $1,036 and $12,615, following the World Bank classification using the Atlas method as of 1 July 2013. In 2013, there are 103 countries in this category.[1] The World Bank distinguishes this group of countries further, classifying those countries with a per capita GNI of less than $4,036 as lower middle-income countries. It does not recognize the United Nations category of least developed countries, but instead identifies low-income countries as one category in terms of its lending policies. In this sense, middle-income countries are defined as an intermediate category in terms of per capita income alone, unlike the category of least developed countries, which also considers economic and environmental vulnerability and the level of human development.

4. Middle-income countries constitute about 74 per cent of world population and 45 per cent of world gross product, measured in terms of purchasing power parity. This significant weight in the world economy also lends additional importance to the relatively strong aggregate growth performance of middle-income countries over the past years, especially in view of the protracted weaknesses in the high-income economies in the aftermath of the recent financial crisis. At the same time, the further intensification of trade and financial ties among middle-income countries and between middle-income and other developing countries in the broad context of South-South cooperation are also helping to make overall growth performances less volatile through a greater diversification of sources of growth.

5. However, middle-income countries are facing a number of challenges, including widespread poverty; inequality in income, opportunities and access to basic needs and services; growing environmental pollution and degradation, with significant effects, among others, for public health, especially in urban areas with high population density; social constraints, such as the limitations for women and girls in many countries to gain fully equal access to education, training and jobs; malnutrition; high levels of child mortality; limited or no access to sanitation; and a lack of adequate health-care systems in numerous countries. This illustrates the

[1] The number of middle-income countries quoted in the text with regard to the development assistance provided to them or surveys conducted in those countries reflects their status as a middle-income country during the implementation of assistance programmes or surveys.

multidimensional nature that characterizes development. In this sense, classifying a country based solely on an average monetary value can justifiably be seen as incomplete and in need of refinement.[2]

6. At the national level, despite their heterogeneity, many middle-income countries are facing a crucial development challenge. For many such countries, their place in the world economy in relative terms implies production costs (in particular unit labour costs) that exceed those of the low-income countries, while their lack of technological competitiveness keeps them below the ranks of high-income economies. This phenomenon of countries being trapped at their current development stage is analysed in more detail in section II.B of this report.

7. For policymakers in middle-income countries, designing and implementing effective development policies requires integrated approaches that cover a wide range of economic, social and environmental areas. This includes in the economic area, for example, the promotion of certain industries through financial incentives and an environment that is generally conducive to private enterprise; improvements in the education system that are relevant to and linked up with the specific needs of the real sectors in the economy; better infrastructure such as transportation, communication and energy networks; better and more widely available and accessible health-care systems; and a reliable and transparent institutional framework that includes in particular the clear assignment and protection of property rights or traditional forms of ownership. Given the multidimensional nature of development, individual countries will naturally differ in the precise set of their challenges and hence also the ideal policy measures. However, this still leaves room for synergies and the transfer of experiences in the policy sphere.

II. Major challenges for the development of middle-income countries

A. Recent macroeconomic and development trends

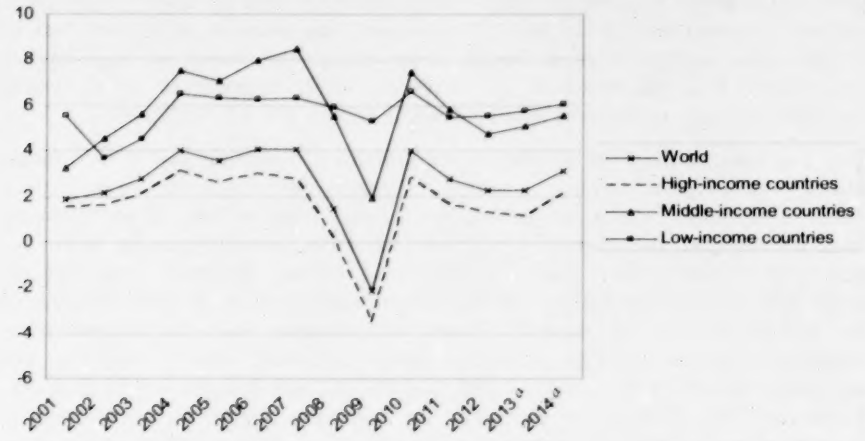
1. Economic growth

8. At the peak of the global economic crisis in 2008 and 2009, when economic activity contracted in the world as a whole, as well as in high-income countries, the group of middle-income countries still achieved a moderately positive average growth rate (figure I). In subsequent years, middle-income countries have continued to outperform other groups, posting an average aggregate growth rate of 6 per cent from 2010 to 2012, twice as high as the average growth in world GDP. Among the subregions, middle-income countries in Asia registered the highest average growth rate from 2010 to 2012 with 7.5 per cent (figure II), while the average growth rate of 3.3 per cent in Africa was at the lower end of the spectrum. In the latest economic

[2] For more details regarding the shortcomings of the classification based on per capita income, see Economic Commission for Latin America and the Caribbean, "Financing for development and middle-income countries: new challenges" (Santiago, 2011). An alternative proposal to classify middle-income countries by different levels of capital market access is made in Peter Fallon and others, "Middle-income countries: development challenges and growing global role" (Washington, D.C., World Bank, 2001).

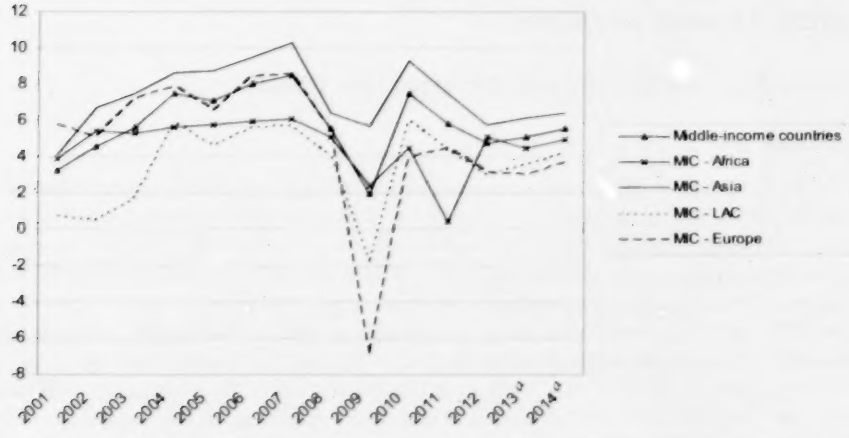
outlook, growth in middle-income countries is expected to remain robust in 2013-2014.[3]

Figure I
Annual real GDP growth according to country classifications (percentage change)



Source: Department of Economic and Social Affairs.
[a] United Nations forecasts.

Figure II
Annual real GDP growth of middle-income countries by region (percentage change)



Source: Department of Economic and Social Affairs.
[a] United Nations forecasts.

[3] This analysis is based on the classification of middle-income countries as of July 2012. Data are from the WESP/LINK database of the Department of Economic and Social Affairs, unless otherwise stated. For a detailed analysis of the global economic outlook, see *World Economic Situation and Prospects 2013* (United Nations publication, Sales No. E.13.II.C.2) and *World Economic Situation and Prospects: Update as of mid-2013*.

9. The headline growth trajectory of middle-income countries requires several qualifications. First, there is a diverse range of growth performances among them. For example, middle-income countries in Asia at times registered growth rates almost twice as high as those for European middle-income countries, as the latter suffered from the European debt and economic crisis through their close trading and financial ties with the euro area, reducing their overall growth rates.

10. In addition, the economic crisis appears to have led to a long-lasting impact on the overall growth of middle-income countries. The average aggregate growth rate for middle-income countries of 6 per cent for 2010-2012 stands in contrast to their average aggregate growth rate of 7.8 per cent in the three years before the crisis (2005-2007). The sharpest slowdown in rates of growth occurred in middle-income countries in Africa, from 5.9 per cent to 3.3 per cent, and in Europe, from 7.8 per cent to 3.8 per cent. Middle-income countries were especially exposed to the crisis through a myriad of transmission channels, such as trade, commodity prices, international capital flows and remittances.

11. Moreover, per capita growth has been significantly lower than overall growth for a number of middle-income countries, particularly for those with high fertility rates, especially in Africa. The average per capita growth rate for African middle-income countries reached 2.9 per cent in 2012, while the average for Asia was 4.7 per cent. Such significant growth disparities also imply sharp differences in the prospects for reducing poverty, both because of the compounding effect and the often already lower starting base level of per capita income. This is especially relevant for middle-income countries, where 37 per cent of the population lives on less than $2 per day.[4]

2. International trade

12. The trend of middle-income countries playing an increasingly important role in global trade remains intact, with the share of exports by these countries in total global exports having increased in every year since 2000, from 25.2 per cent in 2000 to 32.8 per cent in 2012. However, this trend was largely driven by middle-income countries in Asia, which registered almost a doubling of their share in global exports, from 11.9 per cent to 20.4 per cent, over this time span. Middle-income countries in Europe also saw their share increase, albeit only moderately. In contrast, the countries in Latin America and the Caribbean and Africa experienced a decline in their share of global exports. Countries with more diversified and higher value added exports appear to have seen a more positive trend for their share than those with a more resource-based export structure.

13. Trade also plays a relatively more significant role within the economies of middle-income countries than those of other groups. On average, exports constituted 36.8 per cent of GDP in middle-income countries in 2012, compared to 32.9 per cent for the world and 31.5 per cent for high-income countries. Of the individual regions, only middle-income countries in Latin America and the Caribbean showed a markedly lower share of 23.8 per cent. Overall, this leaves middle-income countries, and especially those exporting only one or a few commodities, relatively exposed to the trends in global trade.

[4] World Bank, World Development Indicators 2013.

3. Foreign direct investment

14. Foreign direct investment (FDI) flows to middle-income countries have increased steadily over the past two decades, reaching over $600 billion in 2012, although they have fluctuated in the past few years since the global financial crisis.[5] Available data from the United Nations Conference on Trade and Development indicate that more than half of inward FDI stock in the middle-income group is in the services sector[6] compared to four fifths for the high-income group and 30 per cent for the low-income group, illustrating the fact that the share of services in total FDI rises with economic development. As a result of the development of medium-technology industries and the liberalization of services, the group of middle-income countries has been able to attract investments from both developed and developing firms and from a wide range of industries. Meanwhile, outward capital flows from middle-income countries have increased significantly in recent years.

4. Inflation

15. Inflation rates have, on average, fallen in the middle-income countries, reaching 5.9 per cent in 2012. Middle-income countries in Africa posted the highest aggregate level of inflation with 7.8 per cent in 2012, while those in Europe showed the sharpest decline, from 15.3 per cent in 2008 to 5.7 per cent in 2012. The generally weaker growth has been a major moderating influence on inflation rates. However, in relative terms, inflation in middle-income countries remains about twice as high as the global average and three times as high as in high-income countries, underpinned by factors such as solid demand on the back of revenues from exports of natural resources, below average harvests, military conflicts and capital inflows due to the extremely accommodative monetary policies in high-income countries.

16. The relatively high inflation rates in middle-income countries have significant macroeconomic and social implications. First, they limit the monetary policy space to support growth through a more accommodative stance. At the same time, inflation reduces the purchasing power of households, which becomes an especially serious issue when, as is the case in middle-income countries, many people barely have enough income to satisfy their basic needs.

5. Debt sustainability

17. The ratio of total government debt to GDP for middle-income countries as a whole stood at 47.3 per cent in 2012, a slight increase from 45.5 per cent in 2011.[7] Meanwhile, their total external debt increased moderately from 21.2 per cent to 22.3 per cent of GDP during the same time span (figure III). While these overall numbers are relatively low in historical terms and the debt sustainability of middle-income countries can be characterized as encouraging, the debt situation remains problematic in a number of middle-income countries. This is the case especially in

[5] United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2013. Global Value Chains: Investment and Trade for Development* (United Nations publication, Sales No. E.13.II.D.5).

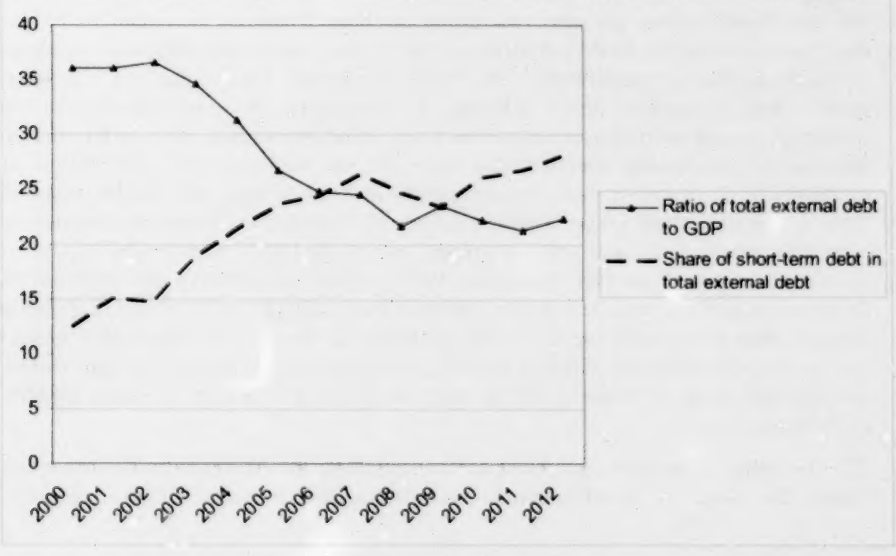
[6] Those data refer to a subgroup of middle-income countries.

[7] This analysis is based on the chapter on debt sustainability in the forthcoming *Millennium Development Goals Gap Task Force Report 2013*. The data have been recalculated specifically for the group of middle-income countries.

some small States that face a combination of unique macroeconomic conditions and sovereign debt challenges. For example, in the Caribbean, a number of countries stabilized and even reduced their public debt ratios before the global financial crisis, underpinned by economic growth. However, the crisis then had a severely negative impact on these countries because of their close linkages with the United States and Europe and a significant reduction in tourism income. Policy responses included higher public expenditure to support growth and limit the negative impact on employment, resulting in increased public debt.

18. The composition of the public debt of middle-income countries has been characterized by two important trends. First, the share of short-term debt in external debt has increased for these countries as a whole from 12.5 per cent in 2000 to 28 per cent in 2012 (figure III). This can pose a significant refinancing risk, especially in an environment of increasing interest rates that is currently expected in the context of the unwinding of monetary stimulus policies in high-income economies. However, the overall macroeconomic risk is at least partially reduced by the decline in the share of external debt in GDP. Second, some countries have made increasing use of private instead of public borrowing, driven by a number of favourable factors such as strong growth and solid commodity export prices. While private financing broadens the base of available funding, it can also increase debt vulnerability, especially when those loans that are non-concessional are being taken by countries that rely on a narrow export base.

Figure III
Selected debt ratios of middle-income countries (percentage)



Source: International Monetary Fund, database of the *World Economic Outlook April 2013*.

6. Employment and labour markets

19. While the average unemployment rate for middle-income countries increased at the peak of the crisis in 2009, driven especially by the impact of weaker export demand, it has since been receding to its pre-crisis level. However, official data paint only a partial picture of the true conditions in labour markets. For example, in many countries, underemployment and informal employment remain widespread but are often not reflected in any official data. In this context, informal employment also impacts on or holds implications for human rights and child protection issues in a number of countries. In addition, many middle-income countries exhibit significant gender gaps in their labour markets.[8]

20. Moreover, unemployment rates vary significantly by region. While Asia showed the lowest unemployment rate at 4.6 per cent in 2012,[9] not least due to a growth performance based on exporting labour-intensive goods, the reverse is true for countries in Africa. The estimated average unemployment rate of 9.9 per cent in 2012 stems from a number of factors, including a lack of higher value added economic activity and the accompanying generation of more and better jobs. At the same time, African middle-income countries also have the youngest population, with 38 per cent of the total population under 15 years old in 2010.[10] This demographic structure stands to create even more pressure on labour markets in the future.

7. Progress towards the achievement of the Millennium Development Goals in middle-income countries

21. Middle-income countries play a crucial role within the framework of the Millennium Development Goals, as they not only comprise almost three quarters of the world population, but also two thirds of those living on less than $1.25 per day.[11] In addition, the profound nature of the various social and economic problems in many middle-income countries can both compound their impact on individual people and complicate their solution. In particular, in many middle-income countries, people are exposed to greater financial vulnerability, for example due to missing or inadequate social safety nets. In several countries, the notion of vulnerability acquires an even greater weight in light of high HIV/AIDS infection rates. In parallel, there remains a high degree of inequality in many middle-income countries, which tends not only to hinder growth, but also weaken the impact of growth in terms of poverty reduction. With regard to achieving the Millennium Development Goals, middle-income countries have gained further in their relevance through their growing influence at the international level, their measurable impact on low-income countries through growing linkages such as trade and remittances, and the provision of financial aid to other developing countries by some middle-income countries.[12]

22. In terms of progress achieved so far regarding the Millennium Development Goals, the group of middle-income countries offers a mixed picture, although

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[8] International Labour Organization (ILO), "Global employment trends for women" (Geneva, 2012).

[9] Data source: ILO, Key Indicators of the Labour Market database.

[10] Data source: *Revision of the World Population Prospects*, 2010.

[11] Data source for this section: World Bank, World Development Indicator database.

[12] See also Department for International Development, United Kingdom of Great Britain and Northern Ireland, "Achieving the Millennium Development Goals: the middle-income countries" (London, 2004).

remarkable progress has been made in many respects. For example, a number of countries have already achieved a reduction of more than half in the proportion of people living on less than $1.25 per day. In China, this ratio fell from 60.2 per cent in 1990 to 11.8 per cent in 2009 and in Brazil from 17.2 per cent to 6.1 per cent over the same period. Various other countries have seen a reduction in this ratio as well, although to a more limited extent. In India, for example, the ratio fell from 49.4 per cent in 1994 to 32.7 per cent in 2010. The vulnerability of middle-income countries is illustrated by those cases where the ratio showed a pronounced increase, only subsequently to fall back to previous levels or even lower. This occurred for example in Romania, Kazakhstan and Venezuela. In addition, progress in meeting the Millennium Development Goal target on hunger has been uneven, with middle-income countries accounting for 69.6 per cent of global undernourishment.[13]

23. Millennium Development Goal 2 to achieve universal primary education finds particular resonance in the context of a lacking or even absent education system being identified as a major factor holding back the social and economic development of some middle-income countries. Numerous middle-income countries have almost achieved this goal, including Indonesia, the Islamic Republic of Iran, Tunisia and Viet Nam. However, a number of countries still face challenges in ensuring primary education on a universal basis. In Lesotho, for example, the total enrolment ratio reached 75 per cent in 2011, although this comes in the wake of a drop from 70.6 per cent in 1990 to a low of 56.4 per cent in 1999. In Pakistan and Senegal, the ratio still falls short of full enrolment, with 72.1 per cent and 78.9 per cent in 2011, respectively, but represents a sharp increase from previous levels. In a number of middle-income countries, a continued gender disparity in access not just to education, but also to job training and the job market, creates a significant additional dimension of vulnerability for women and girls.

24. A further basic determinant of development is sustainable access to safe drinking water and basic sanitation, an area in which several middle-income countries have seen remarkable progress. This includes, for example, Ghana, where the proportion of the population that uses an improved drinking water source increased from 53 per cent in 1990 to 86 per cent in 2011, and India, which saw an increase in this ratio from 70 per cent to 92 per cent over the same time frame. However, in some countries, more remains to be done to achieve sanitary improvements. In Angola, for example, only slightly more than half of the population had access to safe drinking water and basic sanitation in 2011, despite significant fiscal benefits from oil exports. Meanwhile, in Yemen, the ratio has actually decreased, from 66 per cent in 1990 to 55 per cent in 2011.

25. The global economic crisis constitutes a significant risk factor for the achievement of the Millennium Development Goals. The more immediate impact is likely to stem from increasing poverty rates due to higher unemployment, lower incomes and lower remittances. However, certain effects of the crisis might become apparent only over a longer period of time.[14] These could include, for example, a drop in the completion rate in primary education, as families might be less able to afford education fees or children might have to work in order to contribute to

[13] Food and Agriculture Organization of the United Nations (FAO), "The state of food insecurity in the world" (Rome, 2012).

[14] See also World Bank, *Global Monitoring Report 2010. The MDGs After the Crisis* (Washington, D.C., 2010).

household income, or fiscal pressures could lead to cuts in investment or current spending in primary education. A similar deterioration could occur in other indicators such as child and maternal mortality rates. This only underlines the need for policymakers to remain focused on the basic needs of people in the allocation of public funds, especially at a time of crisis. This applies also to donors of development assistance.

B. The middle-income trap

26. The concept of the "middle-income trap" is relatively new in the economic literature and is subject to some controversy. There is no consensus among economists on the validity of this term, as some question the existence of the "trap" and prefer to use the notion of slowing growth instead.

27. The factual evidence of the last several decades shows that many low-income countries, which recorded a sustained period of rapid economic growth and eventually moved to the middle-income country group, later experienced a significant economic slowdown. The difference in average growth rates for a seven-year period before and after the slowdown in some cases exceeded 10 percentage points. Concurrently, the per capita income gap between those countries and high-income economies remains large and for most of them is in the near term probably unbridgeable. To converge with the high-income countries, they would need rapid and stable economic expansion. The notion of the middle-income trap therefore refers to a situation where a middle-income country, after reaching a certain level of per capita income, cannot move much beyond that income level as its per capita economic growth remains mediocre. For example, of 101 middle-income countries in 1960, only 13 had moved into the high-income category by 2008, while the rest were either trapped in the middle-income group or even regressed to the low-income level.[15] A large group of middle-income countries, many of them in Latin America, are considered today to be caught in a middle-income trap. In the last several decades, they have undergone consecutive periods of growth and decline, with real per capita income fluctuating around a certain level. Although those countries witnessed some acceleration of economic growth at the beginning of the past decade, that expansion was largely driven by a commodity price boom and large inflows of remittances.

28. There are different reasons underpinning the phenomenon of the middle-income trap. In general, low-income countries have larger growth potential, as their growth prospects are strongly related to success in addressing the supply-side bottlenecks of the economy and building up domestic production capacity. Low-income countries can embark on growth through such strategies as switching from agriculture to higher-productivity activities, ongoing urbanization, including women in the labour force, developing the energy sector and other infrastructure, integrating into the global chain of production (starting with providing low-skill labour for manufacturing or the development of extractive industries) and diversifying an initially very narrow output base. However, as wages in those catch-up developing countries rise, the low-skills manufacturing sector loses its competitiveness to lower-income countries, while on the other hand, they cannot compete with the

[15] World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society* (Washington, D.C., 2013), p. 12.

high-income economies in the area of high-skill, high value added products.[16] Gains from urbanization and from absorbing rural labour into manufacturing sectors, as well as the employment of women, eventually taper off and the accumulation of capital stock simultaneously requires more spending to offset its depreciation. As a country reaches middle-income status, it has to find new strategies to sustain growth. After losing wage competitiveness, it has to improve the value added and non-cost competitiveness of production, as well as address the domestic demand in the economy, which is becoming increasingly relevant for further economic growth.

29. However, some middle-income countries, including a number of resource-rich countries that have attained middle-income status due to high oil and mineral prices, remain heavily dependent on primary commodity sectors, with limited value added activities and few linkages to other sectors of the economy (this includes, for example, Angola, Congo, Gabon, Ghana, Nigeria, South Sudan, Sudan and Zambia in sub-Saharan Africa). Many middle-income countries are characterized by specialization in low value added activities (with a few exceptions such as the aviation industry in Brazil), have low investment-to-GDP ratios and low spending on education and research, and in most of these countries the business environment has serious scope for improvement in order to attract FDI flows into non-commodity sectors and encourage domestic private investment. The high degree of inequality, which exists in many middle-income countries, curbs the emergence of a middle class and suppresses domestic demand. Initially weak exchange rates, which bolster growth in the early stages of development in low-income economies, can eventually become a drag on domestic consumption, the import of the latest technologies and the build-up of capital stock, and risk keeping the economies mired in a focus on export-oriented low value added activities. Moreover, a large informal economy may also be an impediment to further economic progress, particularly because of the challenges it poses for tax collection, although with the right policy mix, the informal sector may be transformed into an additional driving force for domestic demand and trade.

30. According to some research based on cross-country evidence, after reaching per capita income of about $17,000 (using 2005 as the base year) and meeting other benchmark criteria regarding factor productivity and the share of manufacturing in output, growth is likely to slow noticeably.[17] However, it is imperative for middle-income countries to graduate to the high-income level, as the failure to do so will incur significant social and economic costs in terms of income, development of infrastructure, public health, addressing poverty and inequality and rising living standards in general, and may even affect political stability.[18] Moreover, a drastic slowdown of growth in major middle-income countries, and especially the so-called BRICS countries (Brazil, Russia, India, China and South Africa), would imply

[16] See, for example, Homi Kharas and Harinder Kohli, "What is the middle-income trap, why do countries fall into it and how can it be avoided?", *Global Journal of Emerging Market Economies*, vol. 3, No. 3 (September 2011).

[17] See, for example, Barry Eichengreen, Donghyun Park and Kwanho Shin, "Growth slowdowns redux: new evidence on the middle-income trap", National Bureau of Economic Research Working Paper No. 18673 (Cambridge, Massachusetts, January 2013) and "When fast growing economies slow down: international evidence and implications for China", National Bureau of Economic Research Working Paper No. 16919 (March 2011).

[18] See, for example, Harpaul Kohli and Natasha Mukherjee, "Potential costs to Asia of the middle income trap", *Global Journal of Emerging Market Economies*, vol. 3, No. 3 (September 2011).

serious spillover effects for the global economy through weaker global aggregate demand and would severely impact countries dependent on commodity exports.

31. The experience of some East Asian countries demonstrates that with the implementation of the appropriate policies, the middle-income trap can be avoided. There is no "one-size-fits-all" policy mix, however. Countries have to shift from initial capital accumulation to faster total factor productivity growth and become able to compete internationally in higher value added sectors. This implies introducing technological modernization, especially for those countries which need to move away from a resource-driven growth pattern, developing the institutional environment to encourage high-tech or industrial development and innovation, expanding export markets and shifting from a predominantly export-oriented to a more balanced pattern of growth. This, in turn, requires substantial investments in infrastructure and energy (some middle-income countries, for example India, the Philippines and Thailand, have large investment needs in that area), research and development and human capital. An efficient education system producing highly-skilled professionals as a precondition for innovation, a transparent and predictable business environment, an efficient financial sector and the existence of a stable middle class are further crucial preconditions in this regard. Even in the middle-income countries, the employment of women still needs to increase. Those countries which are faced with ageing populations may have to reduce dependency ratios by raising the retirement age. Macroeconomic and financial stability is especially important and countries should have macroprudential controls in place. Equally important are the quality of institutions and the business environment.

32. The importance of sustaining growth in middle-income countries, transforming them into high value added economies and putting them on a sustainable development track cannot be overstated. The policy path of trade liberalization, openness to FDI and good-quality institutions followed by many middle-income countries, has not always produced desirable outcomes. Specific government policies (implemented, for example, in East Asia), and in particular industrial policy, have helped to find new comparative advantages and niches in the global economy. In various cases, it was important that public support for the private sector was combined with performance requirements. On the other hand, there are examples of unsuccessful industrial policies, which have led to an inefficient allocation of resources. Even for the successful economies, however, diversification and upgrading to high-skilled industries has been a gradual process, starting with the development of new production in industries where skills were easily transferable (such as steel and electronics) and only afterwards transitioning towards higher value added sectors. Today, countries may skip some intermediate stages of development by adopting more efficient and environmentally friendly technologies and creating better institutions. The middle-income countries cannot simply copy the past development path of the developed countries, particularly the unsustainable patterns of production and consumption. For the middle-income countries, the crucial challenge is to design and implement policies that both promote economic transformation and are inclusive, environmentally friendly and sustainable. High-income countries must provide the technological assistance needed in this regard.

III. Cooperation of the United Nations system with middle-income countries

A. Major achievements in development cooperation with middle-income countries

33. Much of the work of the United Nations in middle-income countries focuses on the elimination of disparities, the promotion of equity and social inclusion, assistance in response to human rights violations, capacity development and advocacy. Advice on policy formulation and implementation and other targeted technical support are also important elements of United Nations engagement in middle-income countries.

34. To provide a more empirical picture of the state of United Nations development cooperation with middle-income countries, the present report makes use of data collected through a survey of programme country Governments. The responses to the survey were received by the Department of Economic and Social Affairs from February to April 2012.[19] For the purpose of this report, a subset of replies from middle-income countries to questions from this wider survey was analysed. Of 107 middle-income countries that received the survey, 76 (71 per cent) submitted replies.

35. The survey results indicated that for 79 per cent of the responding middle-income countries, the relevance of the United Nations system to country development needs has increased over the past four years. Respondents indicated that the contribution of the United Nations system has been especially significant in the area of the environment and sustainable development, followed by health and governance and public administration. In this regard, the cross-boundary nature of environmental issues and the transferability of solutions, especially in the health and governance areas, can be seen as matching well with the attributes and strengths that characterize the United Nations system, especially with respect to promoting the adoption of common practices. Other areas of United Nations contributions that were identified by a significant number of middle-income countries included poverty reduction, human rights and equity and gender equality. As the survey results were treated anonymously, it was not possible to take into account the population size of the respective countries, which may alter the global ranking of priorities.

36. The types of support from the United Nations cited as most relevant by individual countries were: strengthening national capacities for policy and strategy development and supporting training and institution-building. Further areas cited were: providing advice on development policies and strategies; supporting gender equality and women's empowerment; providing knowledge and technical expertise; and supporting studies on topics such as human development and children.

37. In addition, 86 per cent of the responding middle-income countries indicated that the activities of the United Nations are closely or very closely aligned with their

[19] The original survey was conducted in response to General Assembly resolution 64/289. An analysis of the results of the original survey can be found in "Results of survey of programme country Governments" available from http://www.un.org/esa/coordination/pdf/government_survey_report_10_june_2012.pdf.

development needs and priorities. At the same time, 96 per cent indicated agreement or strong agreement with the statement that the efforts of the United Nations are focused on assisting their respective country in achieving the Millennium Development Goals.

38. Looking ahead, in terms of the most important areas for United Nations assistance to middle-income countries in the next four years, the most-cited area was the environment and sustainable development, including climate change, water and environmental sanitation, followed by health and poverty reduction. Regarding the measures that the United Nations should take to become more effective at country level, the strongest support was expressed for a focus on areas where the United Nations has a clear comparative advantage. Further measures that also received strong support included making better use of results-based methods and improving the design of programmes and projects.

39. A significant area of engagement by the United Nations is the facilitation of information exchange regarding middle-income countries. To this end, the United Nations system has organized or participated in conferences focusing on issues such as sustainable development, the United Nations development agenda beyond 2015 and regional cooperation and integration. Examples in this respect include the High-Level Conference of Middle-Income Countries on the theme of "Challenges for sustainable development and international cooperation in middle-income countries: the role of networks for prosperity" that was held from 12 to 14 June 2013 in San José and facilitated by the United Nations Industrial Development Organization, and the regional conference entitled "The middle-income countries perspective on sustainable development in CIS, Eastern and Southern Europe" held on 16 and 17 May 2013 in Minsk. In parallel to this, the Economic and Social Council provides a platform for middle-income countries to share information and expertise as well as to consult with other Member States, civil society and parliamentarians. Moreover, much importance is attributed by United Nations organizations and funds, such as the United Nations Development Programme (UNDP) and the United Nations Population Fund (UNFPA), to expanding regional cooperation networks in middle-income countries in order to include a greater number of academic and technical institutions.

40. During the period 2011-2013, the United Nations system has been actively engaged in middle-income countries. UNDP has implemented a wide range of programmes in around 100 middle-income countries in order to reach internationally agreed development goals, including the Millennium Development Goals. Those UNDP activities were conducted in the framework of its strategic plan and its four focus areas, in accordance with the United Nations Development Assistance Framework and country programme projects in the countries concerned. In middle-income countries, UNDP has worked on poverty and other Millennium Development Goals focus area in 87 countries, on democratic governance in 73 countries, on crisis prevention and recovery in 38 countries and on the environment and energy in 91 countries.

41. Other agencies have addressed the development needs of middle-income countries in accordance with their specific mandates. For example, for the United Nations Children's Fund (UNICEF), human rights and child protection issues remain critical challenges. In addition to ongoing cooperation in health, education, HIV/AIDS and social protection, UNICEF has addressed the challenges of

alternative care for children in the context of deinstitutionalization, the condition of ethnic minority and migrant children, justice for children in contact with the law and the commercial sexual exploitation and trafficking of children. UNICEF has addressed those issues through greater use of piloting for knowledge generation and influencing policy development, strengthening capacities in data collection, real-time analysis, management and reporting and supporting policy change through research and advocacy. In addition, the agency has promoted digital communications and communication for development, strategic leveraging of the private sector for funding and child-friendly partnerships, strategic partnerships and South-South exchange, and worked to align technical skills and capacities to meet the demands of middle-income countries.

42. Most of the current country programmes implemented by UNFPA are in middle-income countries, reflecting the general shift of countries from the low- to middle-income category. Middle-income countries receive about half of all UNFPA resources. UNFPA focuses on promoting universal access to sexual and reproductive health services and reproductive rights in all categories of countries, including the middle-income ones. It is also working in middle-income countries on the so-called "emerging" issues related to population dynamics, including ageing, urbanization, migration and climate change, especially with respect to data collection and analysis, and youth issues. UNFPA promotes broad, inclusive partnerships and facilitates South-South cooperation. The development of a middle-income country strategic plan in Botswana in 2011 in close cooperation with all United Nations agencies and other stakeholders in the country is only one example of building such partnerships. The draft strategic plan of UNFPA for 2014-2017 confirms that the engagement in middle-income countries remains an important part of UNFPA programming and proposes a business model that should increase effectiveness in addressing the needs of middle-income countries, while taking their growing policy capacity into account.

43. The Food and Agriculture Organization of the United Nations (FAO) assisted middle-income countries from 2011 to 2013 by preparing and approving 52 investment operations for a total investment of over $4.78 billion, representing 64 per cent of all investments mobilized in collaboration with FAO main financing partners. FAO assistance has targeted rural entrepreneurship, agricultural competitiveness, productivity and diversification; dissemination of agricultural research and technology; land administration; enhancement of desert biodiversity and livelihoods; management of irrigation and water resources; restoration of forest ecosystems; and management of disaster recovery and natural hazards. Support to middle-income countries over the last three years has mainly been related to Millennium Development Goal 7 on environmental sustainability.

44. The World Food Programme (WFP) has an operational presence in 44 middle-income countries and provides assistance in the areas of safety nets and emergency preparedness and response to support Governments in addressing food insecurity and malnutrition. In Timor-Leste, for example, WFP provides support through food-for-work activities and school feeding programmes.

45. Many activities of the United Nations funds and agencies have been conducted in collaboration with the World Bank Group, the International Fund for Agricultural Development, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank and the African

Development Bank. United Nations agencies also cooperate with regional bodies such as the African Union, the Association of Southeast Asian Nations, the South Asian Association for Regional Cooperation, the Pacific Islands Forum, the Global Environment Facility bilateral donors and Governments.

46. In addition to the operational programmes conducted at the country level, UNDP and other agencies have also undertaken broader initiatives related to middle-income countries. In January 2012, a joint meeting of the Executive Boards of UNDP, UNFPA, the United Nations Office for Project Services, UNICEF, the United Nations Entity for Gender Equality and the Empowerment of Women and WFP was organized to discuss the role and presence of the United Nations system in middle-income countries in achieving internationally agreed development goals. The meeting also involved representatives of Member States and academia, who became actively engaged in the discussion on the subject. This event was one of the key initiatives contributing to the discussion of the engagement of the United Nations system with middle-income countries, in response to the report of the Secretary-General on development cooperation with middle-income countries (A/66/220) and General Assembly resolution 66/212. The participants in the event agreed that middle-income countries remain in need of support from the international community because of their unfinished development agenda, taking into account in particular such aspects as poverty and inequality.

47. Some of the regional bureaux of UNDP are exploring opportunities to start systematically supporting middle-income countries in their respective regions. For instance, in an effort to ensure more engagement with middle-income countries, the new regional programme for Africa will focus on, among other priorities, more upstream policy advisory services and participatory governance to translate growth and natural resource wealth into better social and human development outcomes in Africa. The regional bureau for Latin America and the Caribbean prepared a number of reports and publications and organized a number of events with a middle-income country focus. The draft strategic plan of UNDP for 2014-2017 (DP/2013/12) includes the provision of continuing assistance to middle-income countries.

48. The new strategic partnership agenda for UNDP, which has been implemented since 2009, is seeking to achieve a number of key objectives, such as intensifying South-South cooperation and the partnership with emerging economies to accelerate progress on the Millennium Development Goals and other development goals. This should be accomplished by leveraging trade, finance and knowledge flows within the framework of South-South cooperation, by analysing the policy experiences of those countries that achieved notable progress in their development and by working in partnership with developing countries to benefit from the substantive participation of successful countries, which are becoming new strategic partnership countries in UNDP policy discussions. A number of bilateral agreements have been signed in this context, including partnership agreements to strengthen cooperation on regional and global issues, such as South-South and triangular cooperation. In particular, in 2011 and 2012, UNDP concluded such agreements with India, Indonesia, Mexico, South Africa and Turkey, in addition to the agreements with Brazil and China signed earlier.

B. Engagement of international financial institutions in middle-income countries

49. The World Bank has been aiming to take a flexible and multidimensional approach to assisting middle-income countries.[20] Given the differing development needs of these countries, it has worked with them both as clients and shareholders and provided a wide range of services, depending on the specific conditions in an individual country. These services have included, for example, financial products such as loans, guarantees and risk management instruments, and knowledge and advisory services, including providing services on a reimbursable basis. A further focus has been to make greater use of the capacities of individual countries in financial management and procurement and to increase private sector investment in middle-income countries.

50. The operational activities of the World Bank can be distinguished in different ways. In various middle-income countries, the World Bank supports development policy through significant lending programmes. In other cases, advisory services have been taking on an increasingly significant role, accompanied by a decrease in lending. Some countries are no longer borrowing from the World Bank and instead rely solely on its advisory services, often reimbursing the institution for its services. Clients in this regard also include subnational government entities, State-owned enterprises and other non-sovereign entities, besides central government institutions. These services have been embedded in, and combined with, domestically financed development programmes in a number of cases.

51. The shift towards advisory services is to some extent naturally underpinned by the development path of middle-income countries, as an increasing level of development often implies a relatively less pronounced need for financing but still a significant or possibly even greater need for assistance in strengthening the capacity to implement policies. In this regard, the changing nature of the challenges faced by middle-income countries as they develop is illustrated by a number of examples such as ageing populations, pension reform, trade and tax policy, tertiary education, social inequality, competitiveness and urbanization. Against this background, the World Bank has focused in particular on its role in facilitating the transfer and sharing of knowledge and experiences in its cooperation with middle-income countries. This has included also an emphasis on South-South cooperation, both between middle-income countries and between middle- and low-income countries.

52. Given the potentially significant positive ramifications of inclusive and sustainable growth in middle-income countries in the rest of the world, the World Bank has supported middle-income countries in their role as global actors in various international settings. This strategy is based on the assessment that significant synergies can be harnessed at the global level from development in middle-income countries as regards poverty reduction, international financial stability and global issues such as climate change, the secure supply of food, water and energy and international trade. In this context, the World Bank cooperates with middle-income countries at the country, regional and global levels.

[20] See World Bank, *Development Results in Middle-Income Countries: an Evaluation of the World Bank's Support* (Washington, D.C., 2007).

53. During the period from 2011 to 2013, the International Monetary Fund (IMF) continued to adapt to the increased importance of middle-income countries to address their particular challenges. The Fund continued to provide support to middle-income countries, in particular through its surveillance of macroeconomic and financial developments and policies (analysis, consultations, policy advice) and, if needed, by making the its resources temporarily available through its various lending facilities.

54. With respect to its surveillance activities, the IMF has taken important steps to strengthen their quality and coverage, putting more emphasis on cross-border and cross-sectoral linkages and paying closer attention to the spillover effects of economic policies in the world's largest economies and linkages between the financial sector and the real economy. In this context, the Fund implemented its integrated surveillance decision in January 2013, which strengthened the legal framework for surveillance.[21] That decision makes consultations with Member States based on article IV of the IMF Charter an instrument not only for bilateral surveillance, but also for multilateral surveillance.

55. Regarding its lending facilities, the IMF has made several reforms in recent years, aimed at increasing the flexibility of its financial arrangements.[22] The new flexibility in its lending framework seeks to allow for more effective responses to the varying circumstances of member countries. For example, the Fund has introduced several facilities since the crisis, including a flexible credit line and precautionary and liquidity line. In addition, its instruments for emergency assistance have been consolidated under a new rapid financing instrument, which may be used to support a range of urgent balance-of-payments needs without the need for a fully fledged programme. In May 2013, the IMF also issued a new guidance note for public debt sustainability analysis in market-access countries.[23]

IV. Conclusions and recommendations

56. **There is a broad agreement within the international community that middle-income countries should continue to receive development assistance from the United Nations system and that the assistance provided to them should be improved in many dimensions. As progress is being achieved towards the Millennium Development Goals, the priorities of the international development agenda, including in middle-income countries, are shifting towards sustainable development goals, while at the same time keeping in focus marginalized and vulnerable groups and situations where progress towards the Goals is lagging.**

57. **While the United Nations system is widely represented in middle-income countries, providing development assistance on many fronts, a continuing problem is the lack of an overarching, well-defined strategic framework for development cooperation with these countries, as the principles and modalities**

[21] "IMF surveillance", IMF factsheet available from http://www.imf.org/external/np/exr/facts/surv.htm.

[22] See, for instance, "IMF lending", factsheet, available from http://www.imf.org/external/np/exr/facts/howlend.htm and "IMF's response to the global economic crisis", factsheet, available from http://www.imf.org/external/np/exr/facts/changing.htm.

[23] Available from http://www.imf.org/external/np/pp/eng/2013/050913.pdf.

of this cooperation have yet to be fully defined. This could also help in aligning programme activities more closely with the specific needs of individual middle-income countries and enable better use of financial and substantive synergies between agencies. The United Nations system, compared with other development institutions, has a number of unique advantages, such as its presence in every part of the world, the ability to engage highly-skilled professionals from all countries in its operational activities and a compelling international mandate.

58. One concrete proposal to improve coordination and cooperation in the United Nations system regarding its approach towards middle-income countries is to establish a United Nations inter-agency plan of action.[24] A United Nations working group could be set up and charged with supporting the implementation of such a plan of action, building on existing precedents in developing institutional frameworks.[25] Of particular relevance in this regard is the relatively low cost of this option, as it would predominantly rely on already existing expertise in the system.

59. While the classification of middle-income countries based on per capita income captures significant dimensions of development, it also provides only an incomplete picture that masks significant disparities between and within countries, both in terms of per capita income itself and with respect to other variables that characterize economic and social development. This is even the case when taking into account the distinction between lower- and upper-middle-income countries. In this regard, the General Assembly noted in resolution 64/208 that national averages referring to criteria such as per capita income may not be sufficient to take into account the particularities of middle-income countries.

60. Consequently, a more refined classification system for the development status of countries could be developed to take better into account the multidimensionality of development. This could incorporate, for example, some elements from the methodology used to define the least developed countries, which is based on income, human development indicators and economic and environmental vulnerability. Another possible criterion could be the different levels of international capital market access.[26] Any alternative classification criteria could also be used to define subgroups of middle-income countries, continuing to use per capita income as the primary criterion.

61. The formulation of a common strategic framework and the design of a more refined classification system should be seen in combination with each other. The classification system would serve not only to describe the status quo, but would also be used to measure changes over time and thus the impact of policies. Taken together, a common strategy and a more refined classification system would significantly increase the prospects for a stronger and more

[24] This proposal was discussed in more detail, for example, at the conference on middle-income countries held in Minsk on 16 and 17 May 2013.

[25] Two examples of existing institutional frameworks for coordination and cooperation are the Inter-agency Coordination Group against Trafficking in Persons and the United Nations Inter-Agency Cluster on Trade and Productive Capacity.

[26] Fallon and others, "Middle-income countries" (see footnote 2 above).

targeted policy impact in trying to address the many challenges of middle-income countries.

62. It is also important that enhancing assistance to middle-income countries does not crowd out or impact in any adverse way the development agenda for low-income countries and especially the least developed countries and that, moreover, a mutually beneficial situation through positive spillover and network effects is created for all involved parties.

63. The sustainability of the external debt of middle-income counties should be monitored and for the most vulnerable countries debt resolution programmes should be elaborated. This should be combined with consideration of the wider aspects of the development agenda by the respective funds and agencies.

64. The realities of development assistance today significantly differ from those encountered even 10 years ago. South-South and triangular cooperation have gained increasing importance in delivering aid and transferring technology, knowledge and good practices. The experience of successful middle-income countries may be more suited to other middle-income countries facing similar development challenges. However, the engagement and role of the United Nations system in this context has yet to be defined in more detail.

65. In addressing the problem of limitations of productivity and technological capacities in many middle-income countries, the transfer of relevant technologies would play a vital role. This could be promoted by a facilitation mechanism for the transfer of technologies. However, any such initiative would have to manoeuvre between the patent right protections of the holders of the technologies, who are mostly based in high-income economies, and possible incentive and compensation schemes in order to improve the economic attractiveness of transferring technological knowledge to middle-income countries. This could be relevant not only in raising productivity, but also have a significant impact on making the future growth path of middle-income countries more environmentally sustainable.

66. The previous report on development cooperation with middle-income countries (A/66/220) contained a recommendation to the Member States to consider establishing a high-level panel or an ad hoc working group, which could elaborate, in greater detail, the appropriate framework with which to tackle the development challenges of middle-income countries. Although no such action has been undertaken, in order to acknowledge that the development challenges of middle-income countries may differ from the challenges faced by other groups of countries, the Member States may wish to consider such a proposal, given the ever-increasing importance of middle-income countries for the global economic and social situation.